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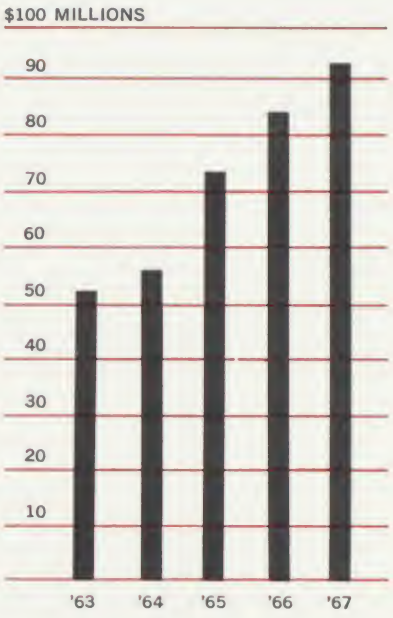
OCT 1 3 1967

GRAY

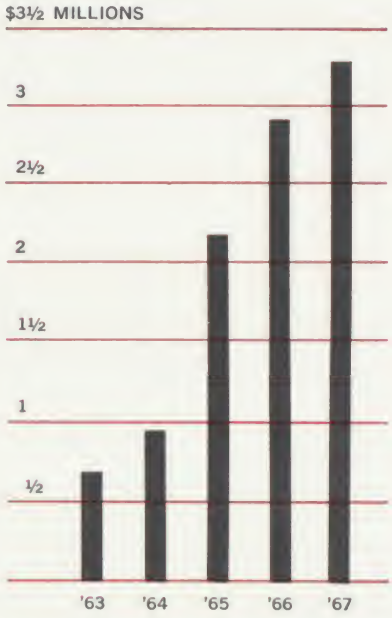
GRAY DRUG STORES, INC. 1967 ANNUAL REPORT

Carpeting and chandeliers in cosmetics department of one of our conventional drug stores, shown in smaller photo, and tile and carpeted entrance to girls apparel department in new Rink's Department Store at Middletown, O., are typical of upgrading constantly under way in all of our retail locations. Gray Drug is a large, diversified retail organization operating conventional drug stores; discount drug stores; prescription and health and beauty aids departments in discount department stores; prescription stores; and two large junior department store chains.

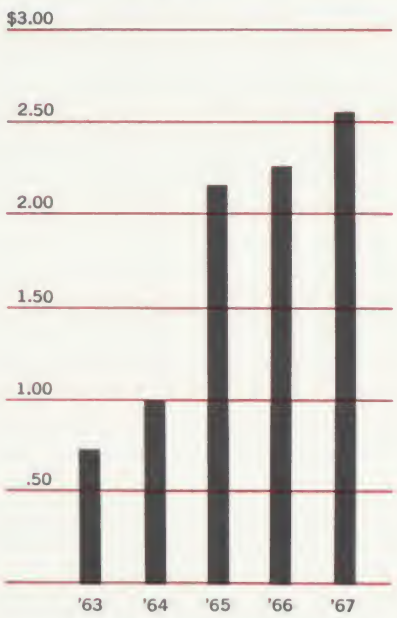
SALES



NET INCOME



EARNINGS PER SHARE



HIGHLIGHTS OF OPERATIONS

Fiscal Years Ended June 30	1967	1966	1965
Net Sales	$93,598,735	$83,352,705	$73,570,697
Net Income	$ 3,256,894	$ 2,912,432	$ 2,176,053
Net Income Per Share	$ 2.51	$ 2.24	$ 2.15
Dividends Per Share	$ .92½	$ .73⅓	$ .56⅔
Working Capital	$15,077,210	$13,786,368	$12,431,574
Current Ratio	2.32 to 1	2.19 to 1	2.21 to 1
Shareholders Equity	$22,099,435	$20,045,091	$13,144,946

STORES AND LEASED DEPARTMENTS

Years Ended June 30	New Stores and Leased Departments	Stores and Leased Departments Closed or Sold	Total Stores and Leased Departments	Stores Remodeled and Enlarged
1963	28	10	152	13
1964	18	19	151	30
1965	25	18	158	39
1966	18	3	173	32
1967	22	8	187	30

LETTER TO SHAREHOLDERS

MR. EVANS

MR. WEINBERGER

Sales of Gray Drug Stores, Inc., established a new record for the 17th consecutive year during the fiscal 12 months ended June 30, 1967. New highs also were established in net income and earnings per share. The quarterly dividend was increased twice. In addition, new products and a substantial acquisition have opened the way for continuing progress ahead.

The sales total of $93,598,735 was 12 per cent above the preceding year, a significant gain in relation to the generally unfavorable national trend in retail sales.

Net income increased 12 per cent to $3,256,894 or $2.51 a share, compared with $2,912,432 or $2.24 a share for the preceding year, as adjusted to reflect a 3 for 2 split of our shares on September 30, 1966.

A Large, Diversified Retailer

Gray Drug is one of the nation's principal drug chains. Volume from our 173 conventional drug stores, discount drug stores, prescription stores, and prescription and health and beauty aids departments in discount department stores totaled $73,439,257 during the past year and is continuing to grow.

We also have developed quite rapidly into a large operator of junior department stores. This adds to our diversity and growth potential, and at the same time provides well-protected new locations for our leased prescription and health and beauty aids departments.

Sales of our Rink's Department Stores Division, acquired three years ago, increased to $20,159,478 during the past year. This is exclusive of $28,000,000 in sales of departments leased by others on Rink's premises.

The success of our Rink's operation led to our acquisition of the Bargain City Stores junior department store chain effective July 1, 1967. The acquisition was principally for cash, plus 30,000 Gray Drug common shares.

Volume of the Bargain City chain, with 13 stores open or under construction, was over $16,000,000 during the past year. Sales of departments operated under lease in its stores totaled about $18,000,000 additional.

With Rink's and Bargain City, our junior department store operations now include 20 large stores with direct sales of approximately $36,000,000 last year and total sales including leased departments of $82,000,000. And two large new department stores will open soon.

Of course, no Bargain City figures are included in our operations for the past year, and volume of leased departments is not included in our statements, except for our own King Division discount drug departments in our department stores. However, rental income from leased operations in our department stores does make an important profit contribution.

Gray Drug, in short, remains a large and growing drug chain, but we also are a large mass merchandiser in the junior department store field, with a major new growth dimension added to our long-range planning.

Many Growth Programs

The total number of retail outlets operated by Gray Drug was 187 at the fiscal year-end, and has now reached 200.

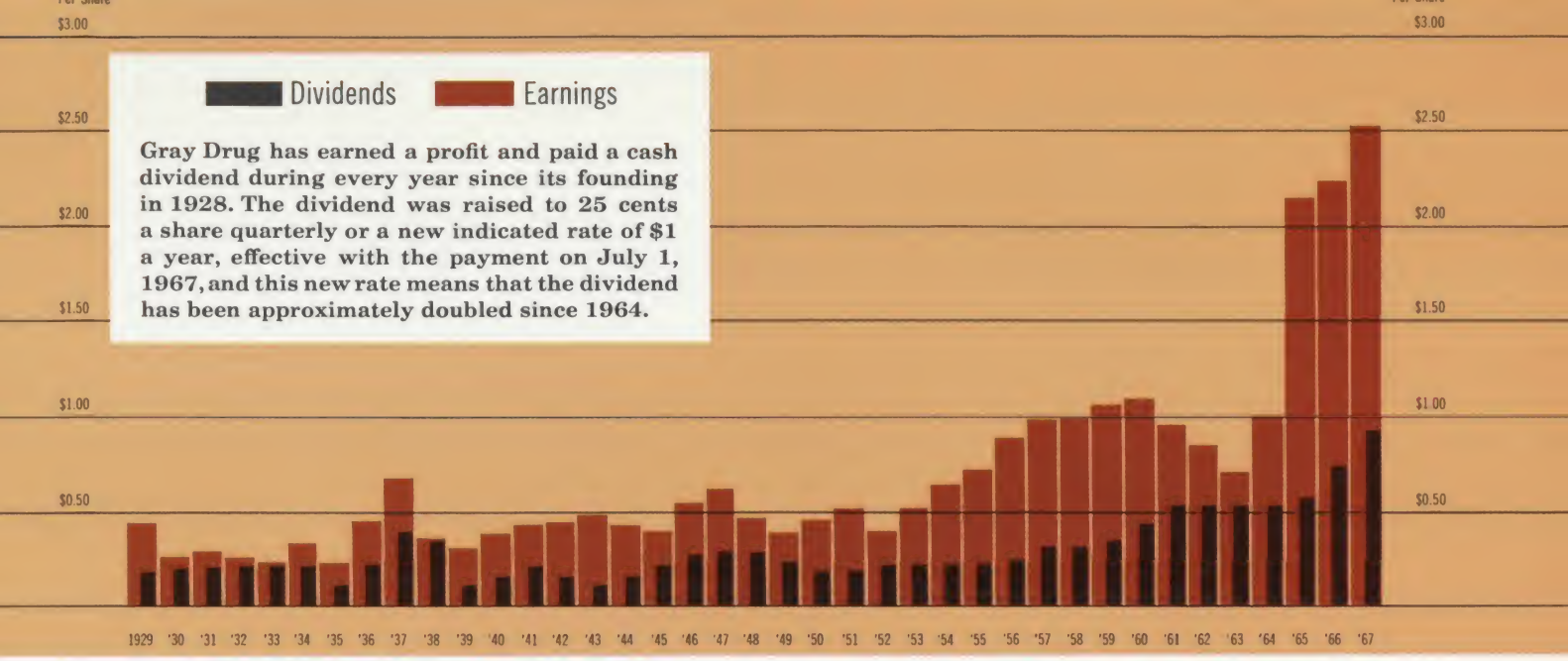
The number of drug stores and health and beauty aid units which we operate was increased by 19 during the past year. A Rink's department store of 100,000 square feet was opened in June. The Rink's Division also operated leased departments in Bargain City stores in Chillicothe and Cambridge, Ohio.

We continue to upgrade and improve existing stores, with 30 units remodeled last year . . . a practice which usually results in increased sales and income.

Rink's has just moved into a newly constructed 80,000 square foot headquarters and warehouse at Cincinnati, built for us under long-term lease.

Our new Bargain City Stores Division is already embarked upon a store expansion and construction program.

Planning has been completed for a new Gray Drug photo processing laboratory made necessary by our increasing volume in this field. The new laboratory will triple our capacity for processing color and black-and-white films.



Gray Drug always has emphasized modern management procedures and careful profit controls, and has pioneered in advanced computer techniques. We have now completed a new computer center featuring a faster and more sophisticated IBM 360 system.

Financial Position

There was no long-term debt at the fiscal year-end. We have since arranged lines of bank credit in the amount of $8,000,000, against which we borrowed $3,750,000 for the Bargain City acquisition and current growth projects.

Current assets were at a record $26,511,492 at the fiscal year-end, in a 2.32 ratio to current liabilities of $11,434,282. Working capital of $15,077,210, shareholder equity of $22,099,435 and book value per share of $17.00 also were at all-time highs.

Substantial pay increases were negotiated last fall with retail unions representing employees, and we were faced with all of the other expense increases encountered by business generally during the past year. However, net income was equal to a return of 3.48% on sales, approximately level with the preceding year, indicating that we were able to absorb rising costs successfully.

With our substantial reserves, credit, and current cash generation, we remain in a strong financial position for continuing long-range progress.

Dividend Increases

The quarterly dividend rate was increased to 22½ cents per share with the payment made October 31, 1966, and to 25 cents per share with the payment made July 1, 1967, or a present indicated annual rate of $1 a share. This was an increase of 25 per cent in the past year, and Gray Drug has now paid a cash dividend for 38 consecutive years.

New York Stock Exchange

We believe that we meet the listing requirements of the New York Stock Exchange. Figures for the past year's operations have been submitted to the Exchange, and we expect their approval to submit a formal application for listing in the very near future.

Current Outlook

The current year will be one of major growth. Our two newest Rink's stores should add at least $5,000,000 in sales, and a number of new units are already open or scheduled by our other divisions. The new Bargain City Stores Division adds another very substantial plus.

Most of our stores are in suburban areas where consumer traffic is building steadily, and as a diversified merchandiser, we are in a position to benefit from any increase in consumer spending.

Profit improvement in our business depends on a strong economy, and it is too early for meaningful forecasts. However, it should be noted that Bargain City's operations during the past year would have added approximately 60 cents per share to our earnings on a pro forma basis.

As a regional chain, with operations concentrated in suburban areas adjacent to Ohio's principal cities, we are able to enjoy maximum advertising impact and to maintain close budgetary control from our headquarters offices. This adds to our profit opportunities.

Volume is continuing at encouraging levels in the booming industrial areas where our stores are located. Assuming that the national economy will remain strong, we anticipate substantial additional volume improvement during the current year in all divisions. This expected increase plus the sales of our new Bargain City Division should carry us well above the $100,000,000 mark in sales.

Sincerely,

C. W. Evans,
Chairman

Jerome A. Weinberger,
President

September 22, 1967

OPERATIONS REPORT AND GROWTH PLANNING

Our stores feature highly competitive pricing, but we are equally interested in maximum quality, in wide product selection, and in making each store a pleasant and attractive place to shop.

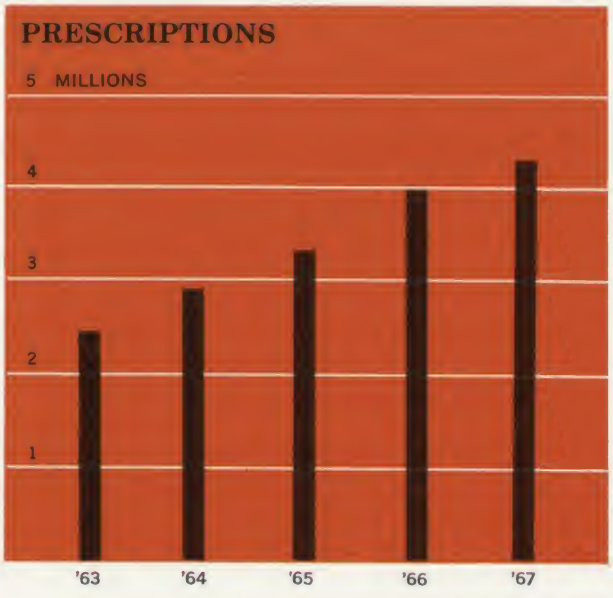
Carpeting, chandeliers, decorator colors, and unique departmental display techniques are provided at a rapidly growing number of stores. We train our own cosmetic consultants, and cashiers learn the rules of good customer relations at other classes. The world's most prestigious brand names can be found in our stores . . . at cosmetic and candy counters, for example.

There is a constant upgrading of stores and product lines. We can afford to be selective in regard to store locations, and we are most often located in the best shopping centers and fastest-growing suburban locations.

At Gray, King, Rink's and Bargain City stores, we consider a prestige reputation to be a primary asset, providing the firmest possible foundation for continuing progress.

Drug Chain Activities

The more than 350 pharmacists at our Gray Division conventional drug stores and our King Division discount drug units filled 4,264,833 prescriptions last year. Prescription sales totaled $13,876,661, an increase of 19 per cent over the preceding year, and accounted for 20½ per cent of the volume of the Gray and King divisions. Annual increases in the number and dollar volume of prescriptions filled have been constant over a long period.



We have arranged with a leading old-line pharmaceutical manufacturer to provide us with an extensive line of prescription drugs for sale by generic or common name as contrasted to brand name. This generally can cut the price of prescriptions more than 50 per cent, and is a considerable innovation in our industry.

Of course, we continue to provide leading brand name pharmaceuticals and take no stand in the brand name versus common name controversy. The choice is strictly up to the physician. However, we are now able to assure him maximum quality if he wants to prescribe by generic name at a savings to patients.

Our good reputation with customers is helping us to build volume of our relatively new line of products provided under our own brand name. Sales of this line were up 50 per cent last year to about $1,500,000.

The Gray-brand vitamin products line has been expanded to 32 items, and our dental products, shaving products, hair care, cough and cold remedy, toiletries, and medicine chest groups also were increased in size, and a new household products line introduced. Packaging has been greatly improved. This private label line is profitable, and also enables us to provide savings to our customers.

Gray Division

Our Gray Division was operating 113 conventional drug stores at the year-end, and sales increased 3.5 per cent to $47,654,671 during the year.

These are large stores, usually 7500 to 12,000 square

ATTRACTIVE DECOR of our Gray Division conventional drug stores is shown in photos at right, taken at two of our newer stores. Many of these have entrances from the enclosed malls of new shopping centers, such as the entrance which is illustrated. Record and wine departments are proving excellent traffic and profit builders. Candy departments are receiving new emphasis. Dutch Oven restaurants are provided at many of our stores.

GRAY DRUG

RECORDS

PHOTO

PRESCRIPTIONS
VITAMIN CENTER
VITAMIN CENTER
VITAMIN CENTER

GIFTS
C A R D
GREETING CARDS

ENTRANCE
HOTO DEPT.
PHOTO
FREE ROLL
FILM
PROJECTORS
G.E.
FLASH BULBS

SUPERIOR PHOTO

feet in size and selling over 25,000 products each, and our goal is simply to make them the finest drug stores in the area we serve.

New stores were opened at Midway Mall in Elyria, O.; Northwest Shopping Center in Columbus, O.; the Chapel Hill Shopping Center in suburban Akron; and in downtown Cincinnati. Three stores were converted to King discount units, one store was sold and one closed. Four new stores are already scheduled for the current year. One of these at Wooster, O., is now open. Another at the new Eastland Mall Shopping Center in Columbus will be ready early in 1968. A mall store at Marion, O., and a medical building unit in Cleveland are scheduled for late fiscal 1968 or early fiscal 1969.

Fourteen stores were remodeled during the past year, and another 17 will be remodeled this year . . . exclusive of the constant departmental up-grading under way in every store. Expansion of our cosmetic departments continues to be a major goal in our remodeling, and this program increases cosmetics sales about 30 per cent per store on the average.

We have been moving candy merchandising up to the front of our stores, with fenced-in departments featuring Whitman and Fanny Farmer brands on an exclusive basis. Photo departments are being enlarged, and our gift departments are being given new importance. Wine and beer departments also are being emphasized, and in more affluent neighborhoods, we are offering wines that do justice to any table.

The cluttered look that is a characteristic of many drug stores has been virtually eliminated in our Gray stores, with neat sign posts replacing overhead banners, and each department provided with its own special "look," that ties in with but is different from that of any other department.

By constantly concentrating a larger number of stores in each city served, we gain greater benefit from saturation advertising, and are stepping up the pace of our special promotions.

LARGE PHOTOGRAPHIC DEPARTMENTS are a part of most of our stores. The one at left above is at a King Division Discount Drug Center. Sales of photo supplies are rising rapidly, and volume of film turned in to our stores for developing was up 30 per cent last year. As a result, we are finalizing plans for construction of a new 30,000 square foot photo processing plant in Cleveland. This new plant, shown in architect's sketch, will triple our capacity for developing color and black-and-white film. We also have a black-and-white photo processing plant in Columbus.

NEW 80,000 SQUARE FOOT HEADQUARTERS and central warehouse completed last spring by our Rink's Department Stores Division in Springdale, a suburb of Cincinnati, is shown at left below. This new building, built for us under lease, will increase Rink's growth capacity and efficiency. Adjacent photo shows warehouse employees pre-marking apparel for sale in nine Rink's Department Stores and five leased departments in our Bargain City Division.

Many New King Outlets

Our King Division at the fiscal year-end was operating 38 leased prescription and health and beauty aids departments in discount department stores, 18 King Discount Drug Center stores, and four leased pharmacies in union health centers. This is a total of 60 units, with 15 opened and three closed, for a net gain of 12 during the past year. King Division volume was nearly $25,800,000, an increase of 16 per cent.

In Columbus, five King discount drug stores were opened, giving us a small chain in that city. The King Division also opened four leased departments in Woolco Department Stores, a division of F. W. Woolworth Company. Another three leased prescription and health and beauty aids departments were opened in our own stores . . . one at Rink's in Middletown, O., and two at Bargain City Stores in Cambridge and Chillicothe, O. A leased drug, health and beauty aids department was opened in the Bargain Mart in Ashtabula, O., and leased photo departments were opened in the Clarkin's stores in Canton and Dayton, O.

KING DISCOUNT
PRESCRIPTIONS
ANTISEPTICS
ANTISEPTICS
ANTISEPTICS
u-test-m
HEATH

KiNG DRUG CENTER
DISCOUNT PRESCRIPTIONS
SHOP THE KING WAY
DISCOUNT PRESCRIPTIONS
PHOTO DEPT.
SMOKE SHOP
PRESCRIPTIONS
PRESCRIPTION

REVLON
69¢
AQUA NET
HAIR SPRAY
88 59¢

ENTRANCE
DRUG DEPT.
CANDY
DISCOUNT
PRESCRIPTIONS
BOOKS
ENTRANCE
PHOTO DEPT.

Our King Division outlets also are being constantly upgraded, with 10 comprehensive remodelings finished last year. Full-line photo departments are now being emphasized, and the King Division has 20 of these, each headed by a highly trained professional and each featuring a large inventory of equipment from Bell & Howell, Eastman, Polaroid, and other leading manufacturers. King Division cosmetic departments also are being expanded, with domestic specialists provided at a number of locations.

The free-standing discount drug stores of the King Division are modern and attractive, differing from our conventional drug stores primarily in that the number of products and package sizes is smaller and the hours of operation are limited to peak consumer buying periods, cutting overhead and making minimum prices possible.

Our leased departments in discount department stores usually provide many products in addition to prescription drugs. These often include cameras and photographic equipment, smoke shop merchandise, candy, books, greeting cards, gift wrap and ribbon, school supplies, stationery, and health and beauty aids of all types.

Such departments enjoy very substantial volume, which is a fine "extra" to the Company when we open or acquire a discount department store. For example, the King Division has eight new units already scheduled for fiscal 1968, some of them already open, and these include one in a new Rink's store and five in stores of our new Bargain City chain.

KING DIVISION discount drug outlets are shown at left. Top photo shows over-all view of discount drug store. Photo at center left shows a leased convalescent supplies department in a union health center, and photo at center right shows exterior of a King Division Discount Drug Center. Lower photos show size of King Division leased department in our new Rink's junior department store at Middletown, O., and close-up of cosmetic section in this department.

Junior Department Stores

Rink's Department Stores and Bargain City Stores may well have been the first two discount department chains in the country. Hyman and Coleman Ullner, the founders of Rink's, and H. R. Swolsky, the founder of Bargain City, began selling surplus merchandise immediately after the end of World War II. Rink's took its name from a skating rink where it set up a discount store, and Bargain City's early operations were in tents and in a shut-down gambling casino.

This history is important, because it means that Rink's, centered in the Cincinnati area, and Bargain City, in the Toledo-Northwestern Ohio area, are very well established, well-known, and respected in separate, fast-growing service areas. Each has emphasized product quality, and each features large stores of up to 100,000 feet in size, located largely in suburban areas, with a large number of leased departments . . . including sizable food retailing operations.

Rink's has always been particularly noted for its capability in the merchandising of soft goods, and Bargain City for its success with appliances and other hard good lines, so that the two operations complement one another in this respect.

Rink's Growing Rapidly

Rink's large store at Bellevue, O., opened a year ago, exceeded its first-year goal of $2,750,000 in direct sales during the past year. The Middletown store, opened in June, 1967, has enjoyed large volume from the start, and the latest store in Mt. Healthy, O., in the Cincinnati area, opens this month.

In addition to its nine large stores, Rink's also operates six soft goods departments in other department stores.

Rink's stores, with approximately 50 large departments in each, ranging from apparel to garden supplies, from prescription drugs to TV sets, from pet supplies to large-volume food supermarket sales, are handsome and pleasant. There is carpeting in the women's apparel departments, and wide use of color and attractive display techniques in spacious surroundings. Optical departments have been opened during the past year, and are doing well.

A volume increase of over 20 per cent is projected by Rink's during the current year, and we currently are seeking additional locations for new Rink's stores.

Bargain City Stores to Expand

Bargain City Stores, ranging from 40,000 to 90,000 square feet in size, are located in Toledo, Lima, Zanesville, Chillicothe, Cambridge, Maumee, Marion, and Defiance, O., and Monroe, Mich. Sales have increased during virtually every year of the chain's existence, and all stores are in suburban areas on main thoroughfares.

Existing stores at Marion and on Woodville Road in Toledo are being greatly expanded to 90,000 square feet in size, and a new store of similar size is being built in Findlay, O.

Each store has about 50 departments, with large leased food supermarkets a part of the larger stores. Headquarters and warehouse are in Toledo.

The greatest strength among departments directly operated by Bargain City is in tools, paint, hardware, plumbing supplies, electrical supplies, housewares, gifts, appliances, jewelry, sporting goods, lawn and garden products and toys. The new Findlay store will go heavily into the tire, battery, and automotive supply business through a new agreement with a national manufacturer of these products.

The combination of Gray Drug management back-up assistance and financial resources has led to rapid growth and substantial profit improvement at Rink's, and we anticipate equal progress at our new Bargain City Stores Division.

A Strong Position

Gray Drug and its subsidiaries, with approximately 4500 regular employees, have become one of the larger and more profitable retailers in the area we serve. We are diversified, growth-minded, and financially strong . . . in an outstanding position to continue the substantial progress that we have enjoyed over a long period in the past and that is perhaps the best guide to our future potential.

RICH DECORATOR MOTIFS and modern display techniques create inviting environment for customers at large new department stores of our Rink's Division. Typical departments in Rink's stores are shown at right. Note the wide central aisle leading to various departments. Each store includes a large grocery, meat market, delicatessen and bakery operated on leased basis. Smaller photo above shows exterior view of new 100,000 square foot Middletown store. Annual volume of our own departments and that of leased departments in a store of this size totals up to $10,000,000.

N'S WEAR

on sale here!
LUCITE

PET DEPT.

HOME FURNISHINGS

CONSOLIDATED BALANCE SHEET Gray Drug Stores, Inc. and Subsidiaries

Assets	June 30, 1967	1966
CURRENT ASSETS		
Cash	$ 2,859,268	$ 2,259,669
United States Treasury Bills — at cost plus accrued interest	—0—	2,959,871
Accounts receivable, less allowance of $30,000	822,562	684,651
Inventories — priced generally on the basis of the lower of cost (latest) or replacement market	22,371,309	19,164,777
Prepaid expenses	458,353	383,589
TOTAL CURRENT ASSETS	$26,511,492	$25,452,557
OTHER ASSETS	277,544	293,648
PROPERTY AND EQUIPMENT — on the basis of cost		
Land (1967 — $161,102; 1966 — $159,982) and buildings	$ 233,675	$ 255,627
Furniture, fixtures and equipment	6,184,187	5,692,688
Leasehold improvements	2,676,886	2,863,450
	$ 9,094,748	$ 8,811,765
Less allowances for depreciation and amortization	3,911,294	4,038,682
	$ 5,183,454	$ 4,773,083
GOOD WILL — Note A	1,561,227	1,191,992
	$33,533,717	$31,711,280

Notes to Financial Statements

NOTE A — GOOD WILL

Good will at June 30, 1967, represents the excess of the cost of investment, to date, over the book value of capital stock of certain companies acquired in a prior year. Under the terms of the purchase agreement, the Company is making additional payments of the purchase price based on the annual net income of the acquired companies through June 30, 1968. Because there has been no diminution in the value attributable to good will, the Company does not now intend to amortize such amount.

NOTE B — LONG-TERM LEASE COMMITMENTS

The Company and subsidiaries are lessees under a number of leases extending from one to twenty-four years. The annual aggregate minimum rental payable under such leases (many of which provide for additional rental if amounts based on specific percentages of sales exceed the minimum) amounted to approximately $3,039,000 at June 30, 1967.

NOTE C — SUBSEQUENT EVENTS

As of July 1, 1967, the Company purchased all of the outstanding capital stock of Washington Distributors, Inc. and

Liabilities and Shareholders' Equity	June 30, 1967	June 30, 1966
CURRENT LIABILITIES		
Trade accounts	$ 6,096,564	$ 6,555,947
Other liabilities and accrued expense	2,211,228	2,225,727
Taxes other than federal income taxes	636,103	506,546
Federal income taxes	2,490,387	2,377,969
TOTAL CURRENT LIABILITIES	$11,434,282	$11,666,189
SHAREHOLDERS' EQUITY		
Common Stock, par value $1 a share:		
Authorized 2,000,000 shares (1966 — 1,000,000 shares)		
Outstanding 1,300,032 shares (1966 — 866,688 shares)	$ 1,300,032	$ 866,688
Capital in excess of par value	8,819,805	9,253,149
Earnings retained for use in the business	11,979,598	9,925,254
TOTAL SHAREHOLDERS' EQUITY	$22,099,435	$20,045,091
LONG-TERM LEASE COMMITMENTS — Note B		
	$33,533,717	$31,711,280

See notes to financial statements.

affiliated companies for the sum of (1) approximately $3,750,000 of which $1,250,000 will be paid in four equal annual installments beginning June 30, 1968, (2) 30,000 shares of Common Stock issued at $25 per share, and (3) additional payments to be based on the annual combined net income of the acquired companies through June 30, 1971. Upon consolidation, the excess of cost of investment over the equity of the companies at acquisition date will be recorded as good will.

On July 1, 1967, the Company executed a revolving credit agreement with a bank, under which it may borrow up to $8,000,000. Any such borrowings will mature on August 1, 1969, and may be converted into a long-term loan payable over a six year period beginning September 30, 1969, with interest at the then prevailing prime commercial rate plus ¼%. The terms of the agreement include covenants covering maintenance of working capital and limiting payment of cash dividends and other capital distributions (as defined) to consolidated net income since July 1, 1967, plus $1,500,000. As of August 29, 1967, the Company had borrowings of $3,750,000 outstanding under the agreement.

STATEMENT OF CONSOLIDATED INCOME AND EARNINGS RETAINED FOR USE IN THE BUSINESS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	Year Ended June 30, 1967	1966
Net sales	$93,598,735	$83,352,705
Other operating income	235,888	205,930
Other income	144,759	107,617
	$93,979,382	$83,666,252
Costs and expenses:		
Cost of goods sold	$62,192,310	$55,746,528
Selling, general, and administrative expenses	24,628,400	21,158,782
Depreciation and amortization	982,297	967,289
Interest expense	88,581	212,621
	$87,891,588	$78,085,220
INCOME BEFORE FEDERAL INCOME TAXES	$ 6,087,794	$ 5,581,032
Federal income taxes	2,830,900	2,668,600
NET INCOME	$ 3,256,894	$ 2,912,432
Earnings retained for use in the business at beginning of year	9,925,254	7,871,627
	$13,182,148	$10,784,059
Cash dividends declared	1,202,550	858,805
EARNINGS RETAINED FOR USE IN THE BUSINESS AT END OF YEAR	$11,979,598	$ 9,925,254
Per share of Common Stock (1966 amounts adjusted for the three-for-two stock split in 1967):		
Net income	$2.51	$2.24
Cash dividends declared	.92-1/2	.73-1/3

See notes to financial statements.

STATEMENT OF CONSOLIDATED SOURCE AND APPLICATION OF FUNDS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	Year Ended June 30, 1967	1966
SOURCE OF FUNDS		
From operations:		
Net income	$3,256,894	$2,912,432
Depreciation and amortization (including deferred debenture expense of $11,131 in 1966) which did not affect working capital	982,297	978,420
TOTAL FROM OPERATIONS	$4,239,191	$3,890,852
Decrease in other assets and miscellaneous	16,104	9,662
	$4,255,295	$3,900,514
APPLICATION OF FUNDS		
Expenditures for property and equipment	$1,392,668	$1,143,985
Principal amount of 5% Convertible Subordinated Debentures redeemed	—0—	163,200
Cash dividends declared	1,202,550	858,805
Additional good will purchased	369,235	379,730
Added to working capital	1,290,842	1,354,794
	$4,255,295	$3,900,514

STATEMENT OF CONSOLIDATED CAPITAL IN EXCESS OF PAR VALUE

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	Year Ended June 30, 1967	Year Ended June 30, 1966
Balance at beginning of year	$9,253,149	$4,597,765
Excess of conversion price over par value of 191,134 shares of Common Stock issued upon conversion of $4,978,100 of 5% Convertible Subordinated Debentures due 1982, less expenses and cash paid in lieu of fractional shares	—0—	4,655,384
	$9,253,149	$9,253,149
Par value of 433,344 shares of Common Stock issued to effect a three-for-two stock split	433,344	—0—
Balance at end of year	$8,819,805	$9,253,149

See notes to financial statements.

ACCOUNTANTS' REPORT

Board of Directors
Gray Drug Stores, Inc.
Cleveland, Ohio

We have examined the consolidated balance sheet of Gray Drug Stores, Inc. and subsidiaries as of June 30, 1967, and the related statements of consolidated income and earnings retained for use in the business, consolidated capital in excess of par value, and consolidated source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying statements identified above present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at June 30, 1967, and the consolidated results of their operations and consolidated source and application of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Ernst, Ernst

Cleveland, Ohio
August 29, 1967

10 YEARS OF PROGRESS

	1967	1966	1965	1964	1963	1962	1961	1960	1959	1958
Net Sales	$93,598,735	$83,352,705	$73,570,697	$57,320,337	$51,875,334	$44,952,417	$39,626,661	$37,552,700	$35,991,537	$32,249,706
Net Income Before Federal Taxes on Income	$ 6,087,794	$ 5,581,032	$ 4,337,653	$ 2,011,104	$ 1,399,066	$ 1,611,213	$ 1,467,793	$ 1,673,989	$ 1,607,591	$ 1,371,322
Net Income	$ 3,256,894	$ 2,912,432	$ 2,176,053	$ 946,404	$ 662,366	$ 801,113	$ 707,793	$ 793,989	$ 768,591	$ 692,322
Income per Common Share (1)	$ 2.51	$ 2.24	$ 2.15	$ 1.00	$ .70	$ .85	$ .95	$ 1.09	$ 1.05	$ .99
Income as a Percentage of Sales	3.48%	3.49%	2.96%	1.65%	1.28%	1.78%	1.78%	2.12%	2.14%	2.15%
Income as a Percentage of Shareholders Equity	14.73%	14.53%	16.55%	8.78%	6.41%	7.87%	9.04%	10.82%	11.20%	11.06%
Cash Dividends Declared —Common Stock	$ 1,202,550	$ 858,805	$ 568,641	503,723	$ 503,723	$ 476,335	$ 393,062	$ 323,850	$ 256,720	$ 218,718
Dividends Per Share (1)	$ .92½	$ .73⅓	$ .56⅔	$ .53⅓	$ .53⅓	$ .53⅓	$ .53⅓	$ .44½	$ .35½	$ .31
Number of Shares Issued (1)	1,300,032	1,300,032	1,013,331	944,481	944,481	944,481	745,143	728,663	728,663	703,863
Net Working Capital	$15,077,210	$13,786,368	$12,431,574	$12,132,632	$11,692,984	$11,599,620	$ 6,218,365	$ 6,087,245	$ 5,630,703	$ 3,691,958
Total Assets	$33,533,717	$31,711,280	$28,532,091	$22,764,138	$21,203,745	$20,296,698	$14,195,991	$14,114,536	$13,262,079	$11,195,293
Long Term Debt	—	—	$ 5,141,300	$ 5,141,300	$ 5,230,000	$ 5,230,000	$ 2,139,200	$ 2,313,500	$ 2,313,500	$ 531,426
Shareholders Equity	$22,099,435	$20,045,091	$13,144,946	$10,783,652	$10,340,971	$10,182,328	$ 7,826,699	$ 7,338,099	$ 6,867,960	$ 6,259,195
Book Value Per Share (1)	$ 17.00	$ 15.42	$ 12.97	$ 11.42	$ 10.95	$ 10.78	$ 10.50	$ 10.07	$ 9.43	$ 8.89
Fixture and Leasehold Additions	$ 1,465,563	$ 1,141,939	$ 1,184,347	$ 813,084	$ 923,337	$ 713,221	$ 901,411	$ 748,758	$ 985,427	$ 903,700
Depreciation	$ 982,297	$ 967,289	$ 869,409	$ 731,322	$ 758,985	$ 667,295	$ 663,750	$ 633,483	$ 575,139	$ 507,717
Units in Operation— End of Year	187	173	158	151	152	134	117	111	107	102

(1) Based upon the number of shares outstanding at the end of each year adjusted to reflect a stock split of 3 for 1 on September 30, 1960, and 3 for 2 stock split on September 30, 1966.

Gray Drug divisions now operate a total of 200 retail outlets. We are the principal drug chain and one of the largest junior department store chains in the area shown on this map. Individual dots indicate cities rather than stores, and one dot may represent from one to 27 stores of the Gray and King divisions. In addition to the locations indicated on this map, we operate two retail outlets in Florida, two in Virginia, and one in California.

- Conventional Drug Stores
- King Division Discount Units
- Rink's Department Stores
- Bargain City Department Stores

BOARD OF DIRECTORS

LLOYD C. DOUGLASS
Vice-President
Gray Drug Stores, Inc.

CARLYLE W. EVANS
Chairman and Chief
Operating Executive
Gray Drug Stores, Inc.

HENRY H. GRAY
Vice-President
Gray Drug Stores, Inc.

MARVIN L. KAHN
Vice-President
Gray Drug Stores, Inc.

C. BERT MCDONALD
Managing Partner
McDonald & Company

GEORGE F. KARCH
President
The Cleveland Trust Company

JOHN W. REAVIS
Managing Partner, Jones, Day,
Cockley & Reavis

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Chairman of the Executive
Committee and Chief Executive
Gray Drug Stores, Inc.

CARL WEINBERGER
Buyer
Gray Drug Stores, Inc.

JEROME A. WEINBERGER
President
Gray Drug Stores, Inc.

OFFICERS

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Committee and Chief Executive

CARLYLE W. EVANS
Chairman and Chief
Operating Executive

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JOSEPH VALINS
Assistant Secretary

KENNETH FREY
Assistant Treasurer

HYMAN ULLNER
President
Rink's Department Stores, Inc.

HYMAN R. SWOLSKY
President
Washington Distributors, Inc.
(Bargain City Division)

TRANSFER AGENT AND REGISTRAR

THE CLEVELAND TRUST COMPANY
Cleveland, Ohio

AUDITORS

ERNST & ERNST
Cleveland, Ohio

STOCK LISTED

MIDWEST STOCK EXCHANGE
Chicago, Illinois

COUNSEL

JONES, DAY, COCKLEY and REAVIS
Cleveland, Ohio

MAIN OFFICE

666 Euclid Ave., Cleveland, Ohio 44114

WAREHOUSE

2400 Superior Ave., Cleveland, Ohio 44114

RINK'S DIVISION HEADQUARTERS

201 W. Crescentville Road, Cincinnati, Ohio 45246

BARGAIN CITY DIVISION HEADQUARTERS

1225 Indiana Avenue, Toledo, Ohio

GRAY DRUG STORES, INC., 666 EUCLID AVENUE, CLEVELAND, OHIO 44114